

104TH CONGRESS  
1ST SESSION

# H. R. 2692

To amend the Internal Revenue Code of 1986 to provide for deductible contributions to medical finance accounts and to reform the earned income credit.

---

## IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 30, 1995

Mr. ROYCE introduced the following bill; which was referred to the Committee on Ways and Means

---

## A BILL

To amend the Internal Revenue Code of 1986 to provide for deductible contributions to medical finance accounts and to reform the earned income credit.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       **TITLE I—MEDICAL FINANCE**  
4       **ACCOUNTS**

5       **SEC. 101. MEDICAL FINANCE ACCOUNTS.**

6       (a) IN GENERAL.—Part VII of subchapter B of chap-  
7       ter 1 of the Internal Revenue Code of 1986 (relating to  
8       additional itemized deductions for individuals) is amended

1 by redesignating section 220 as section 221 and by insert-  
 2 ing after section 219 the following new section:

3 **“SEC. 220. MEDICAL FINANCE ACCOUNTS.**

4       “(a) DEDUCTION ALLOWED.—In the case of an indi-  
 5 vidual, there shall be allowed as a deduction for the tax-  
 6 able year an amount equal to the aggregate amount paid  
 7 in cash by such individual during such taxable year to a  
 8 medical finance account of such individual.

9       “(b) LIMITATIONS.—

10           “(1) IN GENERAL.—Except as otherwise pro-  
 11 vided in this subsection, the amount allowable as a  
 12 deduction under subsection (a) to an individual for  
 13 any taxable year shall not exceed the greater of—

14           “(A) \$3,000 or, in the case of an individ-  
 15 ual who is married, has a dependent (as defined  
 16 in section 152), or is a dependent (as so de-  
 17 fined) for the taxable year, the amount deter-  
 18 mined under paragraph (3),

19           “(B) in the case of an individual who is  
 20 covered by a catastrophic health plan, the de-  
 21 ductible under such plan, or

22           “(C) the excess of—

23           “(i) the limitation under this para-  
 24 graph (determined without regard to this

1                   subparagraph) for the taxable year and  
 2                   each of the preceding 4 taxable years, over  
 3                   “(ii) the sum of the amounts allowed  
 4                   as a deduction under this section for each  
 5                   of such 4 taxable years.

6           For purposes of subparagraph (C), any of such pre-  
 7           ceding 4 taxable years during which the individual  
 8           did not have a medical finance account shall not be  
 9           taken into account, and any taxable year beginning  
 10          before January 1, 1996, shall not be taken into ac-  
 11          count.

12               “(2) COORDINATION WITH EXCLUSION FOR EM-  
 13          PLOYER CONTRIBUTIONS.—The limitation which  
 14          would (but for this paragraph) apply under this sub-  
 15          section to any individual for any taxable year shall  
 16          be reduced (but not below zero) by the amount  
 17          which would (but for section 106(b)) be includible in  
 18          such individual’s gross income for such taxable year.

19               “(3) SPECIAL RULES FOR MARRIED INDIVID-  
 20          UALS AND FAMILIES.—For purposes of paragraph  
 21          (1)(A)—

22                   “(A) IN GENERAL.—Subject to subpara-  
 23                   graphs (B) and (C), the amount determined  
 24                   under this paragraph, with respect to an indi-  
 25                   vidual who is married or has a dependent (as

defined in section 152) for the taxable year, is \$5,000.

“(B) TREATMENT OF FAMILY AS ONE INDIVIDUAL.—For purposes of subparagraph (A), an individual, the spouse (if any) of such individual, and all dependents of such individual or such spouse shall be treated as 1 individual.

“(C) DIVISION OF AMOUNTS BETWEEN FAMILY MEMBERS.—Individuals who are married to each other may allocate the amount applicable under subparagraph (A) between them in any proportion on which they agree. If there is no such agreement, such amount shall be allocated equally between such individuals. Any individual may allocate to any dependent (as defined in section 152) of such individual any portion of the amount otherwise allocable to such individual under this paragraph.

“(4) SPECIAL RULE IF ONE DEDUCTIBLE APPLIES TO FAMILY.—For purposes of paragraph (1)(B), rules similar to the rules of subparagraphs (B) and (C) of paragraph (3) shall apply with respect to any catastrophic health plan which applies one deductible to—

“(A) an individual, and

1 “(B)(i) the spouse (if any) of such individ-  
2 ual, or

3 “(ii) any dependent of such individual or  
4 such spouse.

5 “(c) MEDICAL FINANCE ACCOUNT.—For purposes of  
6 this section—

7 “(1) MEDICAL FINANCE ACCOUNT.—The term  
8 ‘medical finance account’ means a trust created or  
9 organized in the United States exclusively for the  
10 purpose of paying the qualified medical expenses of  
11 the account holder, but only if the written governing  
12 instrument creating the trust meets the following re-  
13 quirements:

14 “(A) Except in the case of a rollover con-  
15 tribution described in subsection (f)(3), con-  
16 tributions will be accepted—

17 “(i) only in cash, and

18 “(ii) only to the extent not in excess  
19 of the limitation under subsection (b) (de-  
20 termined without regard to paragraph (2)  
21 thereof).

22 “(B) The trustee is a bank (as defined in  
23 section 408(n)), an insurance company (as de-  
24 fined in section 816), or another person who  
25 demonstrates to the satisfaction of the Sec-

1           retary that the manner in which such person  
2           will administer the trust will be consistent with  
3           the requirements of this section.

4           “(C) No part of the trust assets will be in-  
5           vested in life insurance contracts.

6           “(D) The assets of the trust will not be  
7           commingled with other property except in a  
8           common trust fund or common investment  
9           fund.

10          “(E) The interest of an individual in the  
11          balance in his account is nonforfeitable.

12          “(2) QUALIFIED MEDICAL EXPENSES.—The  
13          term ‘qualified medical expenses’ means, with re-  
14          spect to an account holder, amounts paid by such  
15          holder for medical care (as defined in section  
16          213(d)), or long-term care, for—

17               “(A) such individual, the spouse of such  
18               individual, and any dependent (as defined in  
19               section 152) of such individual, or

20               “(B) any member of the family of such in-  
21               dividual or spouse who has attained age 65,  
22          but only to the extent such amounts are not com-  
23          pensated for by insurance or otherwise, and

1           “(3) ACCOUNT HOLDER.—The term ‘account  
2 holder’ means the individual on whose behalf the  
3 medical finance account was established.

4           “(4) CERTAIN RULES TO APPLY.—Rules similar  
5 to the following rules shall apply for purposes of this  
6 section:

7                   “(A) Section 219(d)(2) (relating to no de-  
8 duction for rollovers).

9                   “(B) Section 219(f)(3) (relating to time  
10 when contributions deemed made).

11                   “(C) Except as provided in section 106(b),  
12 section 219(f)(5) (relating to employer pay-  
13 ments).

14                   “(D) Section 408(h) (relating to custodial  
15 accounts).

16           “(d) TAX TREATMENT OF ACCOUNTS.—

17                   “(1) IN GENERAL.—A medical finance account  
18 is exempt from taxation under this subtitle, unless  
19 such account has ceased to be a medical finance ac-  
20 count by reason of the rules referred to in paragraph  
21 (2). Notwithstanding the preceding sentence, any  
22 such account is subject to the taxes imposed by sec-  
23 tion 511 (relating to imposition of tax on unrelated  
24 business income of charitable, etc., organizations).

1           “(2) ACCOUNT ASSETS TREATED AS DISTRIB-  
2           UTED IN THE CASE OF PROHIBITED TRANSACTIONS  
3           OR ACCOUNT PLEDGED AS SECURITY FOR LOAN.—  
4           Rules similar to the rules of paragraphs (2) and (4)  
5           of section 408(e) shall apply to medical finance ac-  
6           counts, and any amount treated as distributed under  
7           such rules shall be treated as not used to pay quali-  
8           fied medical expenses.

9           “(e) TAX TREATMENT OF DISTRIBUTIONS.—

10           “(1) INCLUSION OF AMOUNTS NOT USED FOR  
11           QUALIFIED MEDICAL EXPENSES.—Any amount paid  
12           or distributed out of a medical finance account shall  
13           be included in the gross income of the account hold-  
14           er unless such amount is used exclusively to pay the  
15           qualified medical expenses of such holder.

16           “(2) PENALTY FOR AMOUNTS NOT USED FOR  
17           QUALIFIED MEDICAL EXPENSES.—

18           “(A) IN GENERAL.—The tax imposed by  
19           this chapter for any taxable year in which any  
20           amount is included in gross income by reason  
21           of paragraph (1) shall be increased by 10 per-  
22           cent of such amount.

23           “(B) EXCEPTIONS.—Subparagraph (A)  
24           shall not apply with respect to any amount paid



1 or distributed on or after the date the account  
2 holder—

3 “(i) becomes disabled within the  
4 meaning of section 72(m)(7), or  
5 “(ii) dies.

6 “(3) EXCESS CONTRIBUTIONS RETURNED BE-  
7 FORE DUE DATE OF RETURN.—Paragraph (1) shall  
8 not apply to the distribution of any contribution paid  
9 during a taxable year to a medical finance account  
10 to the extent that such contribution exceeds the limi-  
11 tation under subsection (b) (determined without re-  
12 gard to paragraph (3) thereof) if—

13 “(A) such distribution is received by the  
14 account holder on or before the last day pre-  
15 scribed by law (including extensions of time) for  
16 filing such individual’s return for such taxable  
17 year, and

18 “(B) such distribution is accompanied by  
19 the amount of net income attributable to such  
20 excess contribution.

21 Any net income described in subparagraph (B) shall  
22 be included in the gross income of the account hold-  
23 er for the taxable year in which it is received.

24 “(4) ROLLOVERS AND TRANSFERS AT  
25 DEATH.—Paragraph (1) shall not apply to any

1 amount paid or distributed out of a medical finance  
2 account if the entire amount received (including  
3 money and any other property) is paid into another  
4 medical finance account for the benefit of—

5 “(A) such holder,

6 “(B) the spouse of such holder,

7 “(C) any dependent of such holder who has  
8 attained age 21 as of the date of the payment  
9 or distribution, or

10 “(D) in the case of a payment or distribu-  
11 tion made by reason of the death of such hold-  
12 er, the beneficiary designated by such holder,  
13 not later than the 60th day after the date of such  
14 payment or distribution.

15 “(5) COORDINATION WITH MEDICAL EXPENSE  
16 DEDUCTION.—For purposes of section 213, any pay-  
17 ment or distribution out of a medical finance ac-  
18 count for qualified medical expenses shall not be  
19 treated as an expense paid for medical care.

20 “(6) TRANSFER OF ACCOUNT INCIDENT TO DI-  
21 VORCE.—The transfer of an individual’s interest in  
22 a medical finance account to his spouse or former  
23 spouse under a divorce or separation instrument de-  
24 scribed in subparagraph (A) of section 71(b)(2) is  
25 not to be considered a taxable transfer made by such

1 individual notwithstanding any other provision of  
2 this subtitle, and such interest at the time of the  
3 transfer is to be treated as a medical finance ac-  
4 count of such spouse, and not of such individual.  
5 Thereafter such account for purposes of this subtitle  
6 is to be treated as maintained for the benefit of such  
7 spouse.

8 “(f) REPORTS.—The trustee of a medical finance ac-  
9 count shall make such reports regarding such account to  
10 the Secretary and to the account holder with respect to  
11 contributions, distributions, and such other matters as the  
12 Secretary may require under regulations. The reports re-  
13 quired by this subsection shall be filed at such time and  
14 in such manner and furnished to such individuals at such  
15 time and in such manner as may be required by those reg-  
16 ulations.”

17 (b) DEDUCTION ALLOWED WHETHER OR NOT INDIVIDUAL  
18 ITEMIZES OTHER DEDUCTIONS.—Subsection (a)  
19 of section 62 of such Code is amended by inserting after  
20 paragraph (15) the following new paragraph:

21 “(16) MEDICAL FINANCE ACCOUNTS.—The de-  
22 duction allowed by section 220.”

23 (c) EXCLUSIONS FOR EMPLOYER CONTRIBUTIONS  
24 TO MEDICAL FINANCE ACCOUNTS.—

1           (1) EXCLUSION FROM INCOME TAX.—The text  
2           of section 106 of such Code (relating to contribu-  
3           tions by employer to accident and health plans) is  
4           amended to read as follows:

5           “(a) GENERAL RULE.—Gross income of an employee  
6           does not include employer-provided coverage under an ac-  
7           cident or health plan.

8           “(b) CONTRIBUTIONS TO MEDICAL FINANCE AC-  
9           COUNTS.—

10           “(1) IN GENERAL.—In the case of an employee,  
11           gross income does not include amounts contributed  
12           by such employee’s employer to any medical finance  
13           account (as defined in section 220(c)) of such em-  
14           ployee.

15           “(2) NO CONSTRUCTIVE RECEIPT.—No amount  
16           shall be included in the gross income of any em-  
17           ployee solely because the employee may choose be-  
18           tween the contributions referred to in paragraph (1)  
19           and employer contributions to another health plan of  
20           the employer.

21           “(3) COORDINATION WITH DEDUCTION LIMITA-  
22           TION.—The amount excluded from the gross income  
23           of an employee under this subsection for any taxable  
24           year shall not exceed the limitation under section  
25           220(b)(1) (determined without regard to this sub-

1 section) which is applicable to such employee for  
2 such taxable year.”

3 (2) EXCLUSION FROM EMPLOYMENT TAXES.—

4 (A) SOCIAL SECURITY TAXES.—

5 (i) Subsection (a) of section 3121 of  
6 such Code is amended by striking “or” at  
7 the end of paragraph (20), by striking the  
8 period at the end of paragraph (21) and  
9 inserting “; or”, and by inserting after  
10 paragraph (21) the following new para-  
11 graph:

12 “(22) any payment made to or for the benefit  
13 of an employee if at the time of such payment it is  
14 reasonable to believe that the employee will be able  
15 to exclude such payment from income under section  
16 106(b).”

17 (ii) Subsection (a) of section 209 of  
18 the Social Security Act is amended by  
19 striking “or” at the end of paragraph (17),  
20 by striking the period at the end of para-  
21 graph (18) and inserting “; or”, and by in-  
22 serting after paragraph (18) the following  
23 new paragraph:

24 “(19) any payment made to or for the benefit  
25 of an employee if at the time of such payment it is

1 reasonable to believe that the employee will be able  
2 to exclude such payment from income under section  
3 106(b) of the Internal Revenue Code of 1986.”

4 (B) RAILROAD RETIREMENT TAX.—Sub-  
5 section (e) of section 3231 of such Code is  
6 amended by adding at the end the following  
7 new paragraph:

8 “(10) MEDICAL FINANCE ACCOUNT CONTRIBU-  
9 TIONS.—The term ‘compensation’ shall not include  
10 any payment made to or for the benefit of an em-  
11 ployee if at the time of such payment it is reason-  
12 able to believe that the employee will be able to ex-  
13 clude such payment from income under section  
14 106(b).”

15 (C) UNEMPLOYMENT TAX.—Subsection (b)  
16 of section 3306 of such Code is amended by  
17 striking “or” at the end of paragraph (15), by  
18 striking the period at the end of paragraph (16)  
19 and inserting “; or”, and by inserting after  
20 paragraph (16) the following new paragraph:

21 “(17) any payment made to or for the benefit  
22 of an employee if at the time of such payment it is  
23 reasonable to believe that the employee will be able  
24 to exclude such payment from income under section  
25 106(b).”

1 (D) WITHHOLDING TAX.—Subsection (a)  
 2 of section 3401 of such Code is amended by  
 3 striking “or” at the end of paragraph (19), by  
 4 striking the period at the end of paragraph (20)  
 5 and inserting “; or”, and by inserting after  
 6 paragraph (20) the following new paragraph:

7 “(21) any payment made to or for the benefit  
 8 of an employee if at the time of such payment it is  
 9 reasonable to believe that the employee will be able  
 10 to exclude such payment from income under section  
 11 106(b).”

12 (d) EXCLUSION OF MEDICAL FINANCE ACCOUNTS  
 13 FROM ESTATE TAX.—Part IV of subchapter A of chapter  
 14 11 of such Code is amended by adding at the end the fol-  
 15 lowing new section:

16 **“SEC. 2057. MEDICAL FINANCE ACCOUNTS.**

17 “For purposes of the tax imposed by section 2001,  
 18 the value of the taxable estate shall be determined by de-  
 19 ducting from the value of the gross estate an amount  
 20 equal to the value of any medical finance account (as de-  
 21 fined in section 220(c)) included in the gross estate.”

22 (e) TAX ON EXCESS CONTRIBUTIONS.—Section 4973  
 23 of such Code (relating to tax on excess contributions to  
 24 individual retirement accounts, certain section 403(b) con-

1 tracts, and certain individual retirement annuities) is  
 2 amended—

3 (1) by inserting “**MEDICAL FINANCE AC-**  
 4 **COUNTS,**” after “**ACCOUNTS,**” in the heading of  
 5 such section,

6 (2) by redesignating paragraph (2) of sub-  
 7 section (a) as paragraph (3) and by inserting after  
 8 paragraph (1) the following:

9 “(2) a medical finance account (within the  
 10 meaning of section 220(c)),”,

11 (3) by striking “or” at the end of paragraph  
 12 (1) of subsection (a), and

13 (4) by adding at the end thereof the following  
 14 new subsection:

15 “(d) **EXCESS CONTRIBUTIONS TO MEDICAL FINANCE**  
 16 **ACCOUNTS.**—For purposes of this section, in the case of  
 17 a medical finance account (within the meaning of section  
 18 220(c)), the term ‘excess contributions’ means the amount  
 19 by which the amount contributed for the taxable year to  
 20 the account exceeds the limitation under section 220(b)  
 21 for such taxable year. For purposes of this subsection, any  
 22 contribution which is distributed out of the medical fi-  
 23 nance account in a distribution to which section 220(e)(3)  
 24 applies shall be treated as an amount not contributed.”



1 (f) TAX ON PROHIBITED TRANSACTIONS.—Section  
 2 4975 of such Code (relating to tax on prohibited trans-  
 3 actions) is amended—

4 (1) by adding at the end of subsection (c) the  
 5 following new paragraph:

6 “(4) SPECIAL RULE FOR MEDICAL FINANCE AC-  
 7 COUNTS.—An individual for whose benefit a medical  
 8 finance account (within the meaning of section  
 9 220(c)) is established shall be exempt from the tax  
 10 imposed by this section with respect to any trans-  
 11 action concerning such account (which would other-  
 12 wise be taxable under this section) if, with respect  
 13 to such transaction, the account ceases to be a medi-  
 14 cal finance account by reason of the application of  
 15 section 220(d)(2) to such account.”, and

16 (2) by inserting “or a medical finance account  
 17 described in section 220(c)” in subsection (e)(1)  
 18 after “described in section 408(a)”.

19 (g) FAILURE TO PROVIDE REPORTS ON MEDICAL FI-  
 20 NANCE ACCOUNTS.—Section 6693 of such Code (relating  
 21 to failure to provide reports on individual retirement ac-  
 22 counts or annuities) is amended—

23 (1) by inserting “**OR ON MEDICAL FINANCE**  
 24 **ACCOUNTS**” after “**ANNUITIES**” in the heading of  
 25 such section, and

1           (2) by adding at the end of subsection (a) the  
 2           following: “The person required by section 220(f) to  
 3           file a report regarding a medical finance account at  
 4           the time and in the manner required by such section  
 5           shall pay a penalty of \$50 for each failure to so file  
 6           unless it is shown that such failure is due to reason-  
 7           able cause.”

8           (h) CLERICAL AMENDMENTS.—

9           (1) The table of sections for part VII of sub-  
 10          chapter B of chapter 1 of such Code is amended by  
 11          striking the last item and inserting the following:

                  “Sec. 220. Medical finance accounts.  
                   “Sec. 221. Cross reference.”

12          (2) The table of sections for subchapter B of  
 13          chapter 68 of such Code is amended by inserting “or  
 14          on medical finance accounts” after “annuities” in  
 15          the item relating to section 6693.

16          (3) The table of sections for part IV of sub-  
 17          chapter A of chapter 11 of such Code is amended by  
 18          adding at the end the following new item:

                  “Sec. 2057. Medical finance accounts.”

19          (i) EFFECTIVE DATE.—The amendments made by  
 20          this section shall apply to taxable years beginning after  
 21          December 31, 1995.

1       **TITLE II—REFORM OF THE**  
2       **EARNED INCOME CREDIT**

3   **SEC. 201. AMENDMENT OF 1986 CODE.**

4       Except as otherwise expressly provided, whenever in  
5 this title an amendment or repeal is expressed in terms  
6 of an amendment to, or repeal of, a section or other provi-  
7 sion, the reference shall be considered to be made to a  
8 section or other provision of the Internal Revenue Code  
9 of 1986.

10 **SEC. 202. EARNED INCOME CREDIT DENIED TO INDIVID-**  
11                   **UALS NOT AUTHORIZED TO BE EMPLOYED IN**  
12                   **THE UNITED STATES.**

13       (a) IN GENERAL.—Section 32(c)(1) (relating to indi-  
14 viduals eligible to claim the earned income credit) is  
15 amended by adding at the end the following new subpara-  
16 graph:

17                   “(F) IDENTIFICATION NUMBER REQUIRE-  
18                   MENT.—The term ‘eligible individual’ does not  
19                   include any individual who does not include on  
20                   the return of tax for the taxable year—

21                   “(i) such individual’s taxpayer identi-  
22                   fication number, and

23                   “(ii) if the individual is married (with-  
24                   in the meaning of section 7703), the tax-

1                   payer identification number of such indi-  
2                   vidual's spouse.”.

3           (b) SPECIAL IDENTIFICATION NUMBER.—Section 32  
4 is amended by adding at the end the following new sub-  
5 section:

6           “(l) IDENTIFICATION NUMBERS.—Solely for pur-  
7 poses of subsections (c)(1)(F) and (c)(3)(D), a taxpayer  
8 identification number means a social security number is-  
9 sued to an individual by the Social Security Administra-  
10 tion (other than a social security number issued pursuant  
11 to clause (II) (or that portion of clause (III) that relates  
12 to clause (II)) of section 205(c)(2)(B)(i) of the Social Se-  
13 curity Act).”.

14          (c) EXTENSION OF PROCEDURES APPLICABLE TO  
15 MATHEMATICAL OR CLERICAL ERRORS.—Section  
16 6213(g)(2) (relating to the definition of mathematical or  
17 clerical errors) is amended by striking “and” at the end  
18 of subparagraph (D), by striking the period at the end  
19 of subparagraph (E) and inserting a comma, and by in-  
20 serting after subparagraph (E) the following new subpara-  
21 graphs:

22                   “(F) an omission of a correct taxpayer  
23 identification number required under section 32  
24 (relating to the earned income credit) to be in-  
25 cluded on a return, and

1           “(G) an entry on a return claiming the  
2           credit under section 32 with respect to net  
3           earnings from self-employment described in sec-  
4           tion 32(c)(2)(A) to the extent the tax imposed  
5           by section 1401 (relating to self-employment  
6           tax) on such net earnings has not been paid.”.

7           (d) EFFECTIVE DATE.—The amendments made by  
8           this section shall apply to taxable years beginning after  
9           December 31, 1995.

10   **SEC. 203. REPEAL OF EARNED INCOME CREDIT FOR INDIVIDUALS WITHOUT CHILDREN.**  
11

12           (a) IN GENERAL.—Subparagraph (A) of section  
13           32(c)(1) (defining eligible individual) is amended to read  
14           as follows:

15                   “(A) IN GENERAL.—The term ‘eligible in-  
16                   dividual’ means any individual who has a quali-  
17                   fying child for the taxable year.”.

18           (b) CONFORMING AMENDMENTS.—Each of the tables  
19           contained in paragraphs (1) and (2) of section 32(b) are  
20           amended by striking the items relating to no qualifying  
21           children.

22           (c) EFFECTIVE DATE.—The amendments made by  
23           this section shall apply to taxable years beginning after  
24           December 31, 1995.

1 **SEC. 204. MODIFICATION OF EARNED INCOME CREDIT**  
2 **AMOUNT AND PHASEOUT.**

3 (a) MODIFICATION OF PHASEOUT.—Subparagraph  
4 (B) of section 32(a)(2) is amended to read as follows:

5 “(B) the sum of—

6 “(i) the initial phaseout percentage of  
7 so much of the adjusted gross income (or,  
8 if greater, the earned income) of the tax-  
9 payer for the taxable year as exceeds the  
10 initial phaseout amount but does not ex-  
11 ceed the final phaseout amount, plus

12 “(ii) the final phaseout percentage of  
13 so much of the adjusted gross income (or,  
14 if greater, the earned income) of the tax-  
15 payer for the taxable year as exceeds the  
16 final phaseout amount.”

17 (b) PERCENTAGES AND AMOUNTS.—

18 (1) IN GENERAL.—Subsection (b) of section 32,  
19 as amended by section 203(b), is amended to read  
20 as follows:

21 “(b) PERCENTAGES AND AMOUNTS.—

22 “(1) PERCENTAGES.—The credit percentage,  
23 the initial phaseout percentage, and the final phase-  
24 out percentage shall be determined as follows:

“In the case of an eligible individual with:	The credit per- centage is:	The initial phase- out percentage is:	The final phase- out percentage is:
1 qualifying child .....	34	15.98	20
2 or more qualifying children .....	36	21.06	25

1           “(2) AMOUNTS.—The earned income amount,  
2           the initial phaseout amount, and the final phaseout  
3           amount shall be determined as follows:

“In the case of an eligible individual with:	The earned in- come amount is:	The initial phase- out amount is:	The final phase- out amount is:
1 qualifying child .....	\$6,340	\$11,630	\$14,850
2 or more qualifying children .....	\$8,910	\$11,630	\$17,750”.

4           (2) INCREASE IN CREDIT FOR LOWER-INCOME  
5           FAMILIES HAVING 2 OR MORE QUALIFYING CHIL-  
6           DREN.—Subsection (d) of section 32 is amended to  
7           read as follows:

8           “(d) INCREASE IN CREDIT FOR LOWER-INCOME  
9           FAMILIES HAVING 2 OR MORE QUALIFYING CHILDREN.—

10           “(1) IN GENERAL.—If an eligible individual has  
11           2 or more qualifying children, for purposes of apply-  
12           ing paragraphs (1) and (2)(A) of subsection (a)—

13           “(A) the amount of the taxpayer’s earned  
14           income shall be treated as being equal to 10% of  
15           such income (determined without regard to this  
16           paragraph), and

17           “(B) the earned income amount shall be  
18           treated as being equal to 10% of such amount  
19           (determined without regard to this paragraph).

1           “(2) PHASEOUT OF BENEFIT.—If the applicable  
 2           income of the taxpayer for the taxable year exceeds  
 3           \$14,000 (\$17,000 in the case of a joint return), the  
 4           amount of each increase under paragraph (1) shall  
 5           be reduced (but not below zero) by an amount which  
 6           bears the same ratio to such increase (determined  
 7           without regard to this subparagraph) as such excess  
 8           bears to \$4,000.

9           “(3) APPLICABLE INCOME.—For purposes of  
 10          this subsection, the term ‘applicable income’ means  
 11          adjusted gross income or, if greater, earned in-  
 12          come.”

13          (3) CONFORMING AMENDMENTS.—

14                (A) Subsection (j) of section 32 is amend-  
 15                ed—

16                      (i) by striking “subsection (b)(2)(A)”  
 17                      and inserting “subsection (b)(2) or (d)”,

18                      (ii) by striking “1994” and inserting  
 19                      “1996”, and

20                      (iii) by striking “1993” and inserting  
 21                      “1995”.

22                (B) Subsection (e) of section 32 is amend-  
 23                ed to read as follows:

24           “(e) OTHER SPECIAL RULES.—



1           “(1) MARRIED INDIVIDUALS.—In the case of an  
 2           individual who is married (within the meaning of  
 3           section 7703), this section shall apply only if a joint  
 4           return is filed for the taxable year.

5           “(2) TAXABLE YEAR MUST BE FULL TAXABLE  
 6           YEAR.—Except in the case of a taxable year closed  
 7           by reason of the death of an individual, no credit  
 8           shall be allowable under this section in the case of  
 9           a taxable year covering a period of less than 12  
 10          months.”

11          (c) EFFECTIVE DATE.—The amendments made by  
 12          this section shall apply to taxable years beginning after  
 13          December 31, 1995.

14   **SEC. 205. RULES RELATING TO DENIAL OF EARNED IN-**  
 15                   **COME CREDIT ON BASIS OF DISQUALIFIED**  
 16                   **INCOME.**

17          (a) DEFINITION OF DISQUALIFIED INCOME.—Para-  
 18          graph (2) of section 32(i) (defining disqualified income)  
 19          is amended by striking “and” at the end of subparagraph  
 20          (B), by striking the period at the end of subparagraph  
 21          (C) and inserting “, and”, and by adding at the end the  
 22          following new subparagraph:

23                   “(D) the excess (if any) of—

24                           “(i) the aggregate income from all  
 25                           passive activities for the taxable year (de-

1                   terminated without regard to any amount de-  
 2                   scribed in a preceding subparagraph), over  
 3                   “(ii) the aggregate losses from all pas-  
 4                   sive activities for the taxable year (as so  
 5                   determined).

6                   For purposes of subparagraph (D), the term  
 7                   ‘passive activity’ has the meaning given such  
 8                   term by section 469.”.

9           (b) EFFECTIVE DATE.—The amendments made by  
 10 this section shall apply to taxable years beginning after  
 11 December 31, 1995.

12 **SEC. 206. MODIFICATION OF ADJUSTED GROSS INCOME**  
 13 **DEFINITION FOR EARNED INCOME CREDIT.**

14           (a) IN GENERAL.—Subsections (a)(2), (c)(1)(C), (d),  
 15 and (f)(2)(B) of section 32, as amended by the preceding  
 16 sections of this title, are each amended by striking “ad-  
 17 justed gross income” each place it appears and inserting  
 18 “modified adjusted gross income”.

19           (b) MODIFIED ADJUSTED GROSS INCOME DE-  
 20 FINED.—Section 32(c) (relating to definitions and special  
 21 rules) is amended by adding at the end the following new  
 22 paragraph:

23                   “(5) MODIFIED ADJUSTED GROSS INCOME.—

1           “(A) IN GENERAL.—The term ‘modified  
2           adjusted gross income’ means adjusted gross in-  
3           come—

4                   “(i) increased by the sum of the  
5                   amounts described in subparagraph (B),  
6                   and

7                   “(ii) determined without regard to—

8                           “(I) the amounts described in  
9                           subparagraph (C), or

10                           “(II) the deduction allowed under  
11                           section 172.

12           “(B) NONTAXABLE INCOME TAKEN INTO  
13           ACCOUNT.—Amounts described in this subpara-  
14           graph are—

15                   “(i) social security benefits (as defined  
16                   in section 86(d)) received by the taxpayer  
17                   during the taxable year to the extent not  
18                   included in gross income,

19                   “(ii) amounts which—

20                           “(I) are received during the tax-  
21                           able year by (or on behalf of) a spouse  
22                           pursuant to a divorce or separation  
23                           instrument (as defined in section  
24                           71(b)(2)), and

1 “(II) under the terms of the in-  
2 strument are fixed as payable for the  
3 support of the children of the payor  
4 spouse (as determined under section  
5 71(c)),

6 but only to the extent such amounts exceed  
7 \$6,000,

8 “(iii) interest received or accrued dur-  
9 ing the taxable year which is exempt from  
10 tax imposed by this chapter, and

11 “(iv) amounts received as a pension or  
12 annuity, and any distributions or payments  
13 received from an individual retirement  
14 plan, by the taxpayer during the taxable  
15 year to the extent not included in gross in-  
16 come.

17 Clause (iv) shall not include any amount which  
18 is not includible in gross income by reason of  
19 section 402(c), 403(a)(4), 403(b)(8), 408(d)  
20 (3), (4), or (5), or 457(e)(10).

21 “(C) CERTAIN AMOUNTS DISREGARDED.—  
22 An amount is described in this subparagraph if  
23 it is—

24 “(i) the amount of losses from sales  
25 or exchanges of capital assets in excess of

1 gains from such sales or exchanges to the  
2 extent such amount does not exceed the  
3 amount under section 1211(b)(1),

4 “(ii) the net loss from the carrying on  
5 of trades or businesses, computed sepa-  
6 rately with respect to—

7 “(I) trades or businesses (other  
8 than farming) conducted as sole pro-  
9 prietorships,

10 “(II) trades or businesses of  
11 farming conducted as sole proprietor-  
12 ships, and

13 “(III) other trades or business,

14 “(iii) the net loss from estates and  
15 trusts, and

16 “(iv) the excess (if any) of amounts  
17 described in subsection (i)(2)(C)(ii) over  
18 the amounts described in subsection  
19 (i)(2)(C)(i) (relating to nonbusiness rents  
20 and royalties).

21 For purposes of clause (ii), there shall not be  
22 taken into account items which are attributable  
23 to a trade or business which consists of the per-  
24 formance of services by the taxpayer as an em-  
25 ployee.”.

1 (c) EFFECTIVE DATE.—The amendments made by  
 2 this section shall apply to taxable years beginning after  
 3 December 31, 1995.

4 **SEC. 207. PROVISIONS TO IMPROVE TAX COMPLIANCE.**

5 (a) INCREASE IN PENALTIES FOR RETURN PREPAR-  
 6 ERS.—

7 (1) UNDERSTATEMENT PENALTY.—Section  
 8 6694 (relating to understatement of income tax li-  
 9 ability by income tax return preparer) is amended—

10 (A) by striking “\$250” in subsection (a)  
 11 and inserting “\$500”, and

12 (B) by striking “\$1,000” in subsection (b)  
 13 and inserting “\$2,000”.

14 (2) OTHER ASSESSABLE PENALTIES.—Section  
 15 6695 (relating to other assessable penalties) is  
 16 amended—

17 (A) by striking “\$50” and “\$25,000” in  
 18 subsections (a), (b), (c), (d), and (e) and insert-  
 19 ing “\$100” and “\$50,000”, respectively, and

20 (B) by striking “\$500” in subsection (f)  
 21 and inserting “\$1,000”.

22 (b) AIDING AND ABETTING PENALTY.—Section  
 23 6701(b) (relating to amount of penalty) is amended—

24 (1) by striking “\$1,000” in paragraph (1) and  
 25 inserting “2,000”, and

1           (2) by striking “10,000” in paragraph (2) and  
2           inserting “20,000”.

3           (c) EFFECTIVE DATE.—The amendments made by  
4           this section shall apply to penalties with respect to taxable  
5           years beginning after December 31, 1995.

○

HR 2692 IH—2

HR 2692 IH—3